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Calling All Supreme Court Justices! It Might Be Time to Settle This "Rejection" Business Once and For All: A Look at *Sunbeam Products v. Chicago American Manufacturing* and the Resulting Circuit Split

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**CALLING ALL SUPREME COURT JUSTICES! IT
MIGHT BE TIME TO SETTLE THIS “REJECTION”
BUSINESS ONCE AND FOR ALL: A LOOK AT
*SUNBEAM PRODUCTS V. CHICAGO AMERICAN
MANUFACTURING* AND THE RESULTING CIRCUIT
SPLIT**

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INTRODUCTION

While a bankrupt estate is already in a world of uncertainty, the current jurisprudence surrounding rejection of intellectual property executory contracts does anything but put those involved at ease. Part of the reason for the uncertainty is the fundamentally different policy goals of bankruptcy and intellectual property law.

While an efficient and effective bankruptcy proceeding provides insolvent businesses with a way to preserve their business, the need to protect intellectual property licenses has become increasingly important in recent years. However, balancing these needs has created tension.¹ The ultimate goal in bankruptcy law is to “maximize the

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¹ Peter S. Menell, *Bankruptcy Treatment of Intellectual Property Assets: An Economic Analysis*, 22 BERKELEY TECH. L.J. 733, 737 (2007).

value of a failing or failed” entity’s remaining assets.² By providing trustees and debtors-in-possession the ability to reject contracts that may be harmful to the failing entity, bankruptcy courts are able to accomplish this goal.³

Intellectual property law aims to promote economic growth by “encouraging a robust licensing market to exploit the value of intellectual creativity.”⁴ This goal is best effectuated through freedom of contract and strong enforcement of licensed property rights.⁵

Although Section 365 of the Bankruptcy Code (“the Code”) gives the trustee of a bankrupt intellectual property licensor a limited right to reject unperformed, or executory, contracts,⁶ this right should not eviscerate the licensee’s right to use the property.⁷ Rather, rejection is a means to effectuate bankruptcy law’s policy goals while not giving a windfall to the bankrupt.⁸ At first blush this may seem obvious, however, courts have disagreed as to what it means to reject an executory contract.⁹

In a recent Seventh Circuit decision, *Sunbeam Products, Inc. v. Chicago American Manufacturing, LLC*, Chief Judge Easterbrook held that the rejection of a trademark license did not entitle the trustee to recapture the property.¹⁰ However, prior to *Sunbeam*, many courts had

² *Id.*

³ Menell, *supra* note 1.

⁴ *Id.*

⁵ *Id.*

⁶ 11 U.S.C. § 365(a) (2006) (providing, in relevant part, “the trustee, subject to the court’s approval, may . . . reject any executory contract . . . of the debtor”).

⁷ See *Sunbeam Prods., Inc. v. Chi. Am. Mfg., LLC*, 686 F.3d 372, 377 (7th Cir. 2012) (holding that rejection does not rescind the contract).

⁸ See *id.* If, upon rejection, licensees were to lose their right to use the license and left with a money damages claim, then it is likely the trustee will not suffer a loss from rejecting the contract. As discussed in Part I, it is unlikely the licensee will recover very much, if anything from a prepetition claim for damages.

⁹ Compare *Sunbeam*, 686 F.3d at 377, with *Lubrizol Enterprises, Inc. v. Richmond Metal Finishers, Inc.*, 756 F.2d 1043, 1048 (4th Cir. 1985).

¹⁰ *Sunbeam*, 686 F.3d at 378.

followed a Fourth Circuit decision, *Lubrizol Enterprises v. Richmond Metal Finishers*.¹¹

In 1985, the Fourth Circuit, in *Lubrizol*, prevented a licensee, through the debtor's right to reject an executory contract, from using a technology the debtor had previously licensed.¹² Displeased with this result, Congress, in 1988, enacted Section 365(n) of the Code,¹³ which gives intellectual property licensees the right to continue using the intellectual property it bargained for, even if the representative of the bankrupt estate rejects the contract.¹⁴ As defined by the Code, "intellectual property" includes trade secrets, patents, and copyrights, but does not include trademarks.¹⁵ While Congress apparently

¹¹ 756 F.2d 1043 (4th Cir. 1985); *E.g.*, *In re Logical Software, Inc.*, 66 B.R. 683, 686 (Bankr. D. Mass. 1986).

¹² *Lubrizol*, 756 F.2d at 1048.

¹³ S. REP. NO. 100-505, at 3201 (1988).

¹⁴ 11 U.S.C. § 365(n)(1), which provides:

If the trustee rejects an executory contract under which the debtor is a licensor of a right to intellectual property, the licensee under such contract may elect--

(A) to treat such contract as terminated by such rejection if such rejection by the trustee amounts to such a breach as would entitle the licensee to treat such contract as terminated by virtue of its own terms, applicable nonbankruptcy law, or an agreement made by the licensee with another entity; or

(B) to retain its rights (including a right to enforce any exclusivity provision of such contract, but excluding any other right under applicable nonbankruptcy law to specific performance of such contract) under such contract and under any agreement supplementary to such contract, to such intellectual property (including any embodiment of such intellectual property to the extent protected by applicable nonbankruptcy law), as such rights existed immediately before the case commenced, for--

(i) the duration of such contract; and

(ii) any period for which such contract may be extended by the licensee as of right under applicable nonbankruptcy law.

¹⁵ *Id.* at § 101(35A), which provides:

The term "intellectual property" means--

(A) trade secret;

(B) invention, process, design, or plant protected under title 35;

intended to revisit the trademark issue, it never took action; leaving unanswered questions about the appropriate protection courts should afford trademark licensees.¹⁶

Some judges believe that Section 365(n) represents Congressional recognition of the validity of the *Lubrizol* holding, with respect to trademarks.¹⁷ Congress' choice not to use Section 365(n) to protect trademark licensees has led courts to infer, by negative inference, that in the event a trademark license is rejected, *Lubrizol* is controlling.¹⁸ Therefore, as the argument goes, because Congress created Section 365(n) to ensure intellectual property licensees could retain their rights after rejection, excluding trademarks suggests Congress was comfortable with trademark licensees losing their rights upon rejection.¹⁹

However, the legislative history suggests that Congress enacted Section 365(n) as an exception to *Lubrizol*'s interpretation of "rejection" under Section 365(g), and Congress chose to simply exclude trademarks until more studies could be done.²⁰ Creating a split in the circuits, the Seventh Circuit held in *Sunbeam* that excluding trademarks from Section 365(n) does not effect how courts should

(C) patent application;

(D) plant variety;

(E) work of authorship protected under title 17; or

(F) mask work protected under chapter 9 of title 17;

to the extent protected by applicable nonbankruptcy law.

¹⁶ S. REP. NO. 100-505, at 3204 (1988).

¹⁷ *Sunbeam Prods., Inc. v. Chi. Am. Mfg., LLC* 686 F.3d 372, 375 (7th Cir. 2012). *See also e.g., In re Chipwich, Inc.*, 54 B.R. 427, 431 (Bankr. S.D.N.Y. 1985); *In re Blackstone Potato Chip Co., Inc.*, 109 B.R. 557, 560 (Bankr. D.R.I. 1990); *In re Centura Software Corp.*, 281 B.R. 660, 674 (Bankr. N.D. Cal. 2002); *In re HQ Global Holdings, Inc.*, 290 B.R. 507, 513 (Bankr. D. Del. 2003); *In re Old Carco LLC*, 406 B.R. 180, 211 (Bankr. S.D.N.Y. 2009).

¹⁸ *In re Exide Techs.*, 607 F. 3d 957, 966 (3d Cir. 2010) (Ambro, J., concurring).

¹⁹ *Id.*

²⁰ S. REP. NO. 100-505, at 3202-03.

treat them upon rejection²¹ and that rejection does not entitle trustees to reclaim the licensed property.²²

Part I of this Note discusses the underlying policies of bankruptcy and trademark law. Part II reviews case law pertaining to intellectual property license rejection rights. Part III analyzes the *Sunbeam* decision and its effect on intellectual property license agreements in bankruptcy. Part IV of this Note compares the Seventh Circuit's view of rejection with the Fourth Circuit's view, and concludes that *Sunbeam* properly analyzed Section 365(g). Finally this note suggests that the Supreme Court should settle what it means to reject a trademark license agreement.

I. BANKRUPTCY AND TRADEMARK LAW AND THE POLICIES THEY SERVE

A. Bankruptcy Law and Policy

When a corporation files for bankruptcy, the Code “creates an estate,”²³ which is a separate legal entity from the debtor (or bankrupt corporation).²⁴ In every Chapter 11 bankruptcy the trustee or the debtor in possession owes a fiduciary duty to the bankrupt estate.²⁵ Section 365(a) of the Code grants trustees the right, “subject to the court’s approval,” to “assume or reject any executory contract . . . of the debtor.”²⁶ Courts have “interpreted § 365 as requiring . . . a two-step inquiry to determine the propriety of rejection: first, whether the contract is executory; next, if so, whether its rejection would be advantageous to the bankrupt.”²⁷

²¹ *Sunbeam*, 686 F.3d at 375.

²² *Id.* at 377.

²³ 11 U.S.C. § 541 (2006).

²⁴ Michael T. Andrew, *Executory Contracts in Bankruptcy: Understanding 'Rejection'*, 59 U. COLO. L. REV. 845, 851 (1988).

²⁵ Andrew, *supra* note 24, at 851-52.

²⁶ 11 U.S.C. § 365(a).

²⁷ *Lubrizol Enterprises, Inc. v. Richmond Metal Finishers, Inc.*, 756 F.2d 1043, 1045 (4th Cir. 1985). *See also* *NLRB v. Bildisco & Bildisco*, 465 U.S. 513, 518 (1984) (where the Court first determined that a collective-bargaining agreement was

While not explicitly defined in the Code, a contract may be considered executory if both parties have not fully performed their obligations.²⁸ Many courts hold that an executory contract is one “under which the obligations of both the bankrupt and the other party to the contract are so far unperformed that the failure of either to complete the performance would constitute a material breach excusing the performance of the other.”²⁹

For example, a farmer may lease machinery to a neighboring farmer. The lease may provide that the farmer agrees to loan the machinery to the neighbor and to do all repairs on the machine in exchange for a monthly rental fee. During the course of the lease, both parties have unperformed obligations. A material breach would occur if either party fails to perform its obligation, and thus, the contract is executory.³⁰

Next, to ensure rejection would be advantageous to the bankrupt,³¹ courts generally apply some form of the business judgment rule.³² Rooted in corporate law, “the business judgment rule is a common-law standard of judicial review designed to protect the wide latitude conferred on a board of directors in handling the affairs of the

an executory contract); *In re Petur U.S.A. Instrument Co., Inc.*, 35 B.R. 561, 563 (Bankr. W.D. Wash. 1983); *In re Exide Techs.*, 607 F.3d 957, 964 (3d Cir. 2010) (holding that Exide could not reject an agreement because it was not an executory contract).

²⁸ *In re Crippin*, 877 F.2d 594, 596 (7th Cir. 1989).

²⁹ *Gloria Mfg. Corp. v. Int'l Ladies' Garment Workers' Union*, 734 F.2d 1020, 1022 (4th Cir. 1984) (quoting Countryman, *Executory Contracts in Bankruptcy: Part I*, 57 MINN. L. REV. 439, 460 (1973)).

³⁰ *Id.*

³¹ *In re Logical Software, Inc.*, 66 B.R. 683, 686 (Bankr. D. Mass. 1986) (quoting *Lubrizol Enters., Inc. v. Richmond Metal Finishers, Inc.*, 756 F.2d 1043, 1045 (4th Cir. 1985)).

³² *See* *Group of Inst. Investors v. Chi., M., St. P. & P. R. Co.*, 318 U.S. 523, 550 (1943). *See also* *NLRB v. Bildisco & Bildisco*, 465 U.S. 513, 526 (1984) (holding that in the context of collective-bargaining agreements, a stricter standard than “business judgment” should be applied); Andrew, *supra* note 24, at 895-96.

corporate enterprise.”³³ Directors who make informed business decisions in good faith and who exercise due care are free “from liability for honest errors or mistakes in judgment.”³⁴ In bankruptcy, courts generally accept a bankrupt’s request to reject an executory contract “unless it is shown that the bankrupt’s decision was taken in bad faith or in gross abuse of the bankrupt’s retained business discretion.”³⁵ When a debtor’s main asset is a right to license intellectual property, courts generally approve rejection as a sound business decision.³⁶

Upon rejection, Section 365(g) of the Code treats the estate as if it breached the contract prior to petition.³⁷ As a result, the “nondebtor contracting party has a prepetition general unsecured claim for breach of contract damages, one not entitled to administrative priority.”³⁸

A prepetition claim is simply a “right to payment”³⁹ by a creditor.⁴⁰ These creditors receive, on a pro rata basis, what ever is left

³³ William M. Fletcher, *Fletcher Cyclopedia of the Law of Corporations*, 3A FLETCHER CYC. CORP. § 1036 (2012).

³⁴ *Miller v. Thomas*, 656 N.E.2d 89, 95 (Ill. App. Ct. 1995). *See also* Fletcher, *supra* note 33.

³⁵ *Lubrizol*, 756 F.2d at 1047.

³⁶ *E.g., id.*

³⁷ 11 U.S.C. § 365(g) (2006); *Bildisco & Bildisco*, 465 U.S. at 530; 8B C.J.S. Bankruptcy § 915 (2012).

³⁸ 8B C.J.S. Bankruptcy § 915. *See also* 11 U.S.C. § 365(g).

³⁹ 11 U.S.C. § 101(5), which states in full:

The term “claim” means—

(A) right to payment, whether or not such right is reduced to judgment, liquidated, unliquidated, fixed, contingent, matured, unmatured, disputed, undisputed, legal, equitable, secured, or unsecured; or

(B) right to an equitable remedy for breach of performance if such breach gives rise to a right to payment, whether or not such right to an equitable remedy is reduced to judgment, fixed, contingent, matured, unmatured, disputed, undisputed, secured, or unsecured.

⁴⁰ *Id.* at § 101(10)(A), which provides, “the term ‘creditor’ means [an] entity that has a claim against the debtor that arose at the time of or before the order for relief concerning the debtor.”

in the estate after postpetition administrative expenses have been paid.⁴¹ Postpetition administrative expenses include, among other things, “the actual, necessary costs and expenses of preserving the estate.”⁴² Since postpetition administrative expenses receive priority over prepetition claims, and oftentimes must be paid in full, creditors filing prepetition claims rarely recover the full amount.⁴³

However, the implications of this “breach” are not entirely clear.⁴⁴ While the Code states that rejection “constitutes a breach” of a contract,⁴⁵ courts have interpreted rejection as anything from a “release,”⁴⁶ “of contract obligations,”⁴⁷ to something tantamount to rescission.⁴⁸ These starkly differing interpretations can have significant consequences.⁴⁹

⁴¹ Laura B. Bartell, *Straddle Obligations Under Prepetition Contracts: Prepetition Claims, Postpetition Claims or Administrative Expenses?*, 25 EMORY BANKR. DEV. J. 39, 39 (2008).

⁴² 11 U.S.C. § 503(b).

⁴³ Bartell, *supra* note 41.

⁴⁴ See *Sunbeam Prods., Inc. v. Chi. Am. Mfg., LLC*, 686 F.3d 372, 378 (7th Cir. 2012).

⁴⁵ 11 U.S.C. § 365(g) (which provides “the rejection of an executory contract or unexpired lease of the debtor constitutes a breach of such contract or lease”).

⁴⁶ *NLRB v. Bildisco & Bildisco*, 465 U.S. 513, 528 (1984).

⁴⁷ Andrew, *supra* note 24, at 847.

⁴⁸ See *Lubrizol Enters., Inc. v. Richmond Metal Finishers, Inc.*, 756 F.2d 1043, 1048 (4th Cir. 1985) (where rejection ultimately allowed the debtor to reclaim technology it had previously licensed the use of).

⁴⁹ Compare *Sunbeam*, 686 F.3d at 377 (holding that rejection merely frees the licensor from any further contract obligations, but does not entitle the rejecting party to reclaim the property), with *Lubrizol*, 756 F.2d at 1048 (holding that rejection entitles the rejecting party to recapture the use of the licensed property).

B. Trademark Law and Policy

A trademark is a form of intellectual property that represents the user's brand name.⁵⁰ Trademarks can take the form of a "word, name, symbol, device, or any combination, used or intended to be used to identify and distinguish the goods/services of one seller or provider from those of others, and to indicate the source of the goods/services."⁵¹ Trademarks serve a dual purpose: "to protect both consumers from deception and confusion over trade symbols *and* to protect the plaintiff's infringed trademark as property."⁵²

Unlike a patent or copyright, a trademark is not property in the traditional sense.⁵³ A trademark symbolizes the goodwill of an existing business, and for that reason has no independent property value.⁵⁴ While a patent can be licensed for the sole use of the patent,⁵⁵ a trademark flows with the business it is associated with.⁵⁶

A trademark's value is based in part on the value of the underlying business' goodwill.⁵⁷ Therefore, trademarks encourage companies to produce high quality goods and services and to "invest in building the 'goodwill' surrounding a brand name."⁵⁸ While this function of trademarks promotes innovation, it is the distinctiveness, not the inventiveness, which determines whether a trademark is protected.⁵⁹

⁵⁰ *What is a trademark or servicemark?*, UNITED STATES PATENT AND TRADEMARK OFFICE, <http://www.uspto.gov/trademarks/index.jsp> (last updated Oct. 24, 2012).

⁵¹ UNITED STATES PATENT AND TRADEMARK OFFICE, *supra* note 50.

⁵² J. Thomas McCarthy, *McCarthy on Trademarks and Unfair Competition*, 1 MCCARTHY ON TRADEMARKS AND UNFAIR COMPETITION § 2:2 (4th ed.) (2012).

⁵³ *See* Hanover Star Milling Co., v. Metcalf, 240 U.S. 403, 412 (1916). *See also* McCarthy, *supra* note 52, at § 2:15.

⁵⁴ Sugar Busters LLC v. Brennan, 177 F.3d 258, 265 (5th Cir. 1999).

⁵⁵ Mennell, *supra* note 1, at 741.

⁵⁶ *Id.* at 750.

⁵⁷ *Hanover*, 240 U.S. at 412.

⁵⁸ Mennell, *supra* note 1, at 741.

⁵⁹ *Id.*

Unless a trademark license is an executory contract, it may not be rejected.⁶⁰ As discussed above, an executory contract requires that both parties have material, unperformed obligations.⁶¹ A typical trademark license is executory because the “licensor has continuing quality control obligations and the licensee typically has payment, reporting, marketing, and other continuing performance obligations.”⁶²

For example, in *In re HQ Global Holdings, Inc.*, the agreement at issue required the franchisee to maintain operational standards in at least one HQ center and to pay a monthly royalty to the debtors.⁶³ In addition, the debtor had granted the franchisee exclusive use of HQ trademarks in certain territories.⁶⁴ Therefore, the debtor had a continued obligation to refrain from using the trademark in the franchisee’s territories.⁶⁵ The court held that taken together, the agreement was an executory contract because at the time the bankruptcy petition was filed, both parties had unperformed material obligations.⁶⁶

C. Conflict

Before Congress enacted Section 365(n), intellectual property licensees, assuming *Lubrizol* was correctly decided, were at the mercy of their bankrupt licensor.⁶⁷ Under *Lubrizol*, a debtor could use its rejection power to reclaim licensed intellectual property “in an effort to negotiate better terms.”⁶⁸ If a debtor can simply rescind an

⁶⁰ See *In re Exide Techs.*, 607 F.3d 957, 964 (3d Cir. 2010) (holding that because the agreement did “not contain at least one ongoing material obligation” for the licensee, it was not an executory contract, and thus, Exide could not reject it).

⁶¹ McCarthy, *supra* note 52, at § 18:30.

⁶² Mennell, *supra* note 1, at 764.

⁶³ *In re HQ Global Holdings, Inc.*, 290 B.R. 507, 510 (Bankr. D. Del. 2003).

⁶⁴ *Id.*

⁶⁵ *Id.*

⁶⁶ *Id.*

⁶⁷ See *Lubrizol Enters., Inc. v. Richmond Metal Finishers, Inc.*, 756 F.2d 1043, 1048 (4th Cir. 1985).

⁶⁸ Menell, *supra* note 1, at 768 (assuming *Lubrizol* was correctly decided).

unfavorable license agreement, businesses that rely on licensing could be put out of business.⁶⁹

While this interpretation of rejection has serious consequences once rejection has been approved, it equally affects bargaining power at the negotiation stage. Young companies, for example, licensing their intellectual property are at a bargaining disadvantage because there will always be the concern that the young company may enter bankruptcy and the licensee will lose its right to the intellectual property.

Congress, and even the *Lubrizol* court, agreed that this “would have a chilling effect on the development and licensing of intellectual property.”⁷⁰ As a result, Congress enacted Section 365(n) to protect intellectual property licensees.⁷¹ However, Congress excluded trademarks from Section 365(n), leaving it up to the courts to determine whether trademarks should somehow be protected.⁷²

II. RELEVANT CASE LAW

A. Pre-Section 365(n)

Before the enactment of Section 365(n) of the Code, the Fourth Circuit in, *Lubrizol Enterprises, Inc. v. Richmond Metal Finishers, Inc.*, broadly construed a debtor’s power to reject an executory contract.⁷³ The court held that rejection relinquished the licensee’s

⁶⁹ See *id.* at 768-9.

⁷⁰ Patrick Law, *Intellectual Property Licenses and Bankruptcy – Has the IPLBA Thawed the “Chilling Effects” of Lubrizol v. Richmond Metal Finishers?*, 99 COM. L.J. 261, 261 (1994).

⁷¹ S. REP. NO. 100-505, at 3204 (1988).

⁷² *Id.* (Congress invites bankruptcy courts to use their equitable powers to provide, if any, protection to trademark licensees).

⁷³ See *Sunbeam Products, Inc. v. Chicago Am. Mfg., LLC*, 686 F.3d 372, 377 (7th Cir. 2012) (where the court notes “[s]cholars uniformly criticize, *Lubrizol*” for “confus[ing] rejection with the use of an avoiding power”).

rights under the agreement, leaving the licensee with only a money damages claim.⁷⁴

This is a peculiar decision in light of how we typically think of contract breaches. If a car dealership agrees to provide the lessee with free auto service, but later breaches this agreement by refusing to offer this service, the dealership cannot force the lessee to return the car. Breach generally does not repudiate the contract, but rather, courts will award lessees money damages for the difference in acquiring auto services elsewhere.⁷⁵

In *Lubrizol*, Richmond Metal Finishers (“RMF”) developed a valuable metal coating process.⁷⁶ RMF arranged to sell the technology to Lubrizol in exchange for a percentage of the sales realized as a result of the technology.⁷⁷ The agreement was non-exclusive and RMF agreed to defend Lubrizol in any claims of infringement.⁷⁸

RMF filed for Chapter 11 bankruptcy, and in doing so, intended to reject the Lubrizol technology agreement.⁷⁹ In spite of the bankruptcy court’s approval of RMF’s motion for rejection,⁸⁰ the district court reversed.⁸¹ On appeal, the Fourth Circuit affirmed the bankruptcy court’s decision allowing RMF to reject the Lubrizol agreement.⁸²

⁷⁴ See *Lubrizol Enters., Inc. v. Richmond Metal Finishers, Inc.*, 756 F.2d 1043, 1048 (4th Cir. 1985).

⁷⁵ 24 SAMUEL WILLISTON & RICHARD A. LORD, A TREATISE ON THE LAW OF CONTRACTS § 64:2 (4th ed.). See also *Sunbeam*, 686 F.3d at 377.

⁷⁶ *In re Richmond Metal Finishers, Inc.*, 38 B.R. 341, 342 (E.D. Va. 1984) *rev’d sub nom. Lubrizol*, 756 F.2d 1043 (4th Cir. 1985).

⁷⁷ *Id.*

⁷⁸ *Id.*

⁷⁹ *Lubrizol*, 756 F.2d at 1045 (RMF hoped that rejecting the Lubrizol contract would allow it to capitalize on the proprietary metal coating technology.).

⁸⁰ *Id.* (The bankruptcy court concluded that the Lubrizol contract was executory and rejection would “be advantageous to the bankrupt.”).

⁸¹ *Id.* at 1046 (The district court reversed on the grounds that the Lubrizol contract was not executory and that rejection did not represent sound business judgment.).

⁸² *Id.* at 1048.

In order to reject the Lubrizol agreement, RMF had to show that the agreement was an executory contract, and that “rejection would be advantageous to the bankrupt.”⁸³ The court held that the licensing agreement was an executory contract because, among other duties and obligations, Lubrizol had a duty to pay RMF royalties for the use of the process, while RMF had the continuing obligation to notify Lubrizol if it further licensed the technology.⁸⁴

The next issue was whether rejection would benefit RMF.⁸⁵ RMF’s metal coating process was its most valuable asset.⁸⁶ Requiring RMF to meet its continued obligations with Lubrizol would hinder its ability to further license or sell this process.⁸⁷ Without considering the adverse effect upon Lubrizol, the court found it was within RMF’s sound business judgment to reject the license agreement.⁸⁸

While the court recognized that “rejection in this and comparable cases could have a general chilling effect upon the willingness of such parties to contract at all with businesses in possible financial difficulty,” the court nonetheless held rejection was proper.⁸⁹ The court refused to indulge these equitable considerations because Congress clearly allowed debtors to reject executory contracts, except for two explicit exceptions: “union members under collective bargaining contracts . . . and to lessees of real property.”⁹⁰

Without offering significant analysis, the court cursorily concluded that by rejecting an executory contract, the trustee had a right to regain control of the licensed property.⁹¹ According to the

⁸³ *Id.* at 1045.

⁸⁴ *Id.*

⁸⁵ *Id.* at 1046.

⁸⁶ *Id.* at 1047.

⁸⁷ *Id.*

⁸⁸ *Id.*

⁸⁹ *Id.*

⁹⁰ *Id.* at 1048. 11 U.S.C. § 365(h) (2006). *NLRB v. Bildisco & Bildisco*, 465 U.S. 513, 519.

⁹¹ *Lubrizol*, 756 F.2d at 1048. *See also* *Sunbeam Products, Inc. v. Chicago Am. Mfg., LLC*, 686 F.3d 372, 377 (7th Cir. 2012) (“*Lubrizol* itself devoted scant attention to the question [sic] whether rejection cancels a contract”).

court, Section 365(g) merely allows the non-bankrupt party to recover money damages.⁹² Furthermore, it found that Lubrizol could not continue using the technology despite provisions in the RMF agreement.⁹³

In the three years between the *Lubrizol* decision and the enactment of Section 365(n), other cases similarly held that rejection prevented the non-debtor from using the licensed property.⁹⁴ For example, in *In re Petur U.S.A. Instrument Co.*, the bankruptcy court held that the bankrupt estate could not reject an executory contract because the potential harm to the non-debtor was disproportionately high compared to the benefit to the bankrupt estate.⁹⁵ The court reasoned that rejection would put the non-debtor out of business, suggesting rejection would prevent the non-debtor from any further use of the license.⁹⁶

However, *In re Select-A-Seat Corp.*, decided before the enactment of Section 365(n), held that rejection only applies to the executory part of the contract, and the licensee may continue using the property.⁹⁷ The court stated that “rejection can cancel covenants requiring future performances by the debtor,” but the license “cannot be summarily terminated.”⁹⁸ These cases highlight the varied opinions that courts maintain regarding what it means to reject an executory contract.

⁹² *Lubrizol*, 756 F.2d at 1048. 11 U.S.C. § 365(g) (“[T]he rejection of an executory contract or unexpired lease of the debtor constitutes a breach of such contract or lease.”).

⁹³ *Lubrizol*, 756 F.2d at 1048.

⁹⁴ *In re Petur U.S.A. Instrument Co., Inc.*, 35 B.R. 561, 563 (Bankr. W.D. Wash. 1983). *See also e.g., In re Chipwich, Inc.*, 54 B.R. 427, 431 (Bankr. S.D.N.Y. 1985) (holding that “by rejecting the two licenses the debtor will deprive [the licensee] of its right to use the ‘Chipwich’ trademark for its products”).

⁹⁵ *In re Petur U.S.A. Instrument Co., Inc.*, 35 B.R. at 563-64.

⁹⁶ *Id.* at 563.

⁹⁷ 625 F.2d 290, 292 (9th Cir. 1980).

⁹⁸ *Id.* at 293.

B. Enactment of Section 365(n)

Concerned with the impact *Lubrizol* would have on intellectual property licenses, Congress enacted Section 365(n) in 1988 to prevent “licensors from rejecting executory contracts.”⁹⁹ As a remedial protection for licensees, Congress intended Section 365(n) to clarify that intellectual property licenses cannot be unilaterally terminated by the rejection of a license.¹⁰⁰

Section 365(n) provides licensees with two options in the event of rejection.¹⁰¹ First, the licensee may treat rejection as a breach of contract and seek damages as a creditor.¹⁰² Alternatively, the licensee may retain the rights it had under the agreement before the licensor filed for bankruptcy.¹⁰³ With respect to intellectual property other than trademarks, allowing the licensee to continue using the intellectual property imposes no additional burdens on the trustee, while at the same time, avoids the chilling effect Congress feared.¹⁰⁴ However, the same cannot be said for trademarks.

Trademarks require parties on both sides of the license to perform to some extent.¹⁰⁵ If Section 365(n) included trademarks, a licensee’s ability to retain its rights under the agreement could put substantial burdens on the bankrupt estate. Since trademark licenses “depend to a large extent on control of the quality of the products or services sold by the licensee,” Congress excluded trademarks from the definition of intellectual property as it pertains to Section 365(n) until more studies

⁹⁹ Law, *supra* note 70.

¹⁰⁰ S. REP. NO., 100-505 at 3200 (1988).

¹⁰¹ Law, *supra* note 70, at 266.

¹⁰² See 11 U.S.C. § 365. Law, *supra* note 70, at 266 (which notes that this option was available before Congress enacted § 365(n)). Under *Lubrizol*, this would mean the licensee loses its right to use the intellectual property. *Lubrizol*, 756 F.2d at 1048.

¹⁰³ Law, *supra* note 70, at 266.

¹⁰⁴ *Id.*

¹⁰⁵ Menell, *supra* note 1, at 750 (For example, “any licenses of trademarks--whether exclusive or nonexclusive--must be supervised by the trademark owner in order to avoid abandoning the mark.”).

could be done.¹⁰⁶ Although Congress clearly intended to revisit this matter, it has not yet done so.¹⁰⁷

III. SUNBEAM DECISION

In *Sunbeam Products, Inc. v. Chicago Am. Mfg., LLC*, the Seventh Circuit analyzed the effect of rejecting a trademark license agreement.¹⁰⁸ In addition, the court addressed the broader issue of rejection as it applies to all intellectual property.¹⁰⁹ The Seventh Circuit took this as an opportunity to determine whether *Lubrizol* properly interpreted the effect of rejection under Section 365(g).¹¹⁰

A. The Facts

Lakewood Engineering & Manufacturing Co. manufactured and sold, among other products, box fans.¹¹¹ In 2008, while already losing money, Lakewood contracted its manufacturing out to Chicago American Manufacturing (“CAM”).¹¹² Lakewood authorized CAM to make box fans using Lakewood’s patents and allowed it to adhere Lakewood’s trademark to the fans.¹¹³ In addition, the contract gave CAM the right to sell the remaining 2009 inventory if Lakewood was unable to purchase the fans.¹¹⁴

¹⁰⁶ S. REP. NO. 100-505, at 3204 (1988).

¹⁰⁷ *Id.*

¹⁰⁸ 686 F.3d 372 (7th Cir. 2012) (The district court certified a direct appeal under 28 U.S.C. § 158(d)(2)(A) by Sunbeam Products, doing business as Jarden Consumer Solutions. *Id.* at 374.).

¹⁰⁹ *Id.*

¹¹⁰ *Id.* at 376.

¹¹¹ *In re Lakewood Eng’g & Mfg. Co., Inc.*, 459 B.R. 306, 310 (Bankr. N.D. Ill. 2011) *aff’d sub nom.* Sunbeam Prods., Inc. v. Chi. Am. Mfg., LLC, 686 F.3d 372 (7th Cir. 2012) *cert. denied*, 133 S. Ct. 790 (U.S. 2012).

¹¹² *Id.* at 313.

¹¹³ *Id.*

¹¹⁴ *Sunbeam*, 686 F.3d at 376.

The following year, and merely months into the contract, Lakewood's creditors filed an involuntary Chapter 7 bankruptcy petition against it.¹¹⁵ In an effort to liquidate Lakewood, Sunbeam Products bought Lakewood's assets, which included its intellectual property.¹¹⁶ The court appointed trustee rejected the CAM executory contract, but CAM continued to make and sell the Lakewood fans.¹¹⁷

As a result, Sunbeam filed an adversary action against CAM, claiming it did not have any right to use Lakewood's patents and trademarks.¹¹⁸ The bankruptcy court upheld the contract on equitable grounds.¹¹⁹ The bankruptcy court reasoned that since CAM had already manufactured a significant number of fans with the Lakewood trademark, it was only fair to allow them to sell their inventory.¹²⁰

B. Decision

While not reversing the bankruptcy judge's ruling, the Seventh Circuit found the ruling untenable because it couched the decision in equity.¹²¹ The Seventh Circuit wrote that judges should not rule contrary to the Code merely because they believe enforcing the Code would be inequitable.¹²² Equity takes on different meanings, in different situations, for different judges. While some may think equity favors licensees by allowing them to rely on the strength of the

¹¹⁵ *In re Lakewood*, 459 B.R. at 320.

¹¹⁶ *Id.* at 325.

¹¹⁷ *Id.* at 327-28.

¹¹⁸ *Id.* at 328.

¹¹⁹ *Id.* at 345 (By couching its decision in equity, the bankruptcy judge did not need to determine whether trademarks may be rejected under §§ 365(a) and (n)).

¹²⁰ *See id.* at 343-47.

¹²¹ *Sunbeam*, 686 F.3d at 376. In reference to the recent Supreme Court decision, *RadLAX Gateway Hotel, LLC v. Amalgamated Bank*, Chief Judge Easterbrook stated, "arguments based on views about the purposes behind the Code, and wise public policy, cannot be used to supersede the Code's provisions." *Id.*

¹²² *Id.* at 375.

license, others find equity to favor the creditors, because terminating IP licenses allows the debtor to recover more of its claim.¹²³

However, according to *Sunbeam*, it only matters what the Code says, not where equity lies.¹²⁴ By applying “well established principles of statutory construction,”¹²⁵ *Sunbeam* concluded that Section 365(g) should not be read so expansively that rejection eviscerates the licensee’s right to use the intellectual property.¹²⁶

i. Trademarks

Chief Judge Easterbrook held that CAM may continue using the Lakewood trademarks, despite Lakewood’s rejection of the licensing agreement.¹²⁷ The court reasoned that, although Congress excluded trademarks from its definition of intellectual property,¹²⁸ it did not intend to approve of the principles held in *Lubrizol*.¹²⁹ In fact, Congress intended for Section 365(n) to act as a way for intellectual property licensees to retain possession and use of licenses, despite *Lubrizol* suggesting a licensor could reclaim the property.¹³⁰

While Section 365(n) protects intellectual property licensees, as it is defined in the Code, it is *Sunbeam*’s interpretation of Section 365(g) that protects trademark licensees.¹³¹ However, Section 365(g) only protects trademarks because Section 365(n) leaves trademarks

¹²³ *Id.* at 375-76.

¹²⁴ *Id.* at 376. Chief Judge Easterbrook goes on to quote *RadLAX*, “The Bankruptcy Code standardizes an expansive (and sometimes unruly) area of law, and it is our obligation to interpret the Code clearly and predictably using well established principles of statutory construction.” *RadLAX Gateway Hotel, LLC v. Amalgamated Bank*, 132 S.Ct. 2065, 2073 (2012).

¹²⁵ *RadLAX*, 132 S.Ct. at 2073.

¹²⁶ *Sunbeam*, 686 F.3d. at 376-78.

¹²⁷ *Id.* at 378.

¹²⁸ 11 U.S.C. § 101(35A) (2006).

¹²⁹ *Sunbeam*, 686 F.3d at 375. *See* S. REP. NO. 100-505, at 3200 (1988).

¹³⁰ *See* S. REP. NO. 100-505, at 3200.

¹³¹ *See generally Sunbeam*, 686 F.3d at 377.

unaffected.¹³² This principle is supported by Judge Ambro's concurring opinion in *In re Exide Technologies*, where he stipulated "that [section] 365(n) neither codifies nor disapproves *Lubrizol* as applied to trademarks."¹³³

Although the crux of the *Exide* opinion was whether "a perpetual, exclusive, royalty-free license to use the Exide trademark in the industrial battery business" was an executory contract, Judge Ambro, in his concurring opinion, shed light on how to handle trademarks with regard to Section 365(n).¹³⁴ "For years, it was held that, while [Section 365(n)] covered licenses of most types of intellectual property, by negative implication, it did not cover trademark licenses."¹³⁵ Therefore, according to these courts, *Lubrizol*'s holding would control, and could prevent trademark licensees from using the trademark after rejection.¹³⁶ However, Judge Ambro concluded that courts should use Section 365, coupled with "their equitable powers," to further the

¹³² *Id.* at 375. Chief Judge Easterbrook provided that "[s]ome bankruptcy judges have inferred from the omission [of trademarks from Section 365(n)] that Congress codified *Lubrizol* with respect to trademarks, but an omission is just an omission." *Id.*

¹³³ *Id.* (citing *In re Exide Techs.*, 607 F.3d 957, 966-967 (3d Cir. 2010) (Ambro, J., concurring)).

¹³⁴ *In re Exide*, 607 F.3d at 961, 965 (The court held that Exide could not reject the license because it was not an executory contract.).

¹³⁵ J. Thomas McCarthy, *McCarthy on Trademarks and Unfair Competition*, 1 MCCARTHY ON TRADEMARKS AND UNFAIR COMPETITION § 18:30 (4th ed.) (2012) (citing *In re Centura Software Corp.*, 281 B.R. 660, 669-670 (Bankr. N.D. Cal. 2002) ("Consistent with the statutory language, 365(n)'s legislative history also explicitly states that 'the bill does not address the rejection of executory trademark, trade name or service mark licenses.'")). *See also In re Dynamic Tooling Systems, Inc.*, 349 B.R. 847, 856 (Bankr. D. Kan. 2006) ("Hantover's license to use DTS's trademarks and service marks is not protected by § 365(n) at all because trademarks are not 'intellectual property' as that term is defined in the Code, § 101(35A)"); *In re Old Carco LLC*, 406 B.R. 180, 211 (Bankr. S.D. N.Y. 2009) ("Trademarks are not 'intellectual property' ... [and therefore] rejection of licenses by [a] licensor deprives [the] licensee of [the] right to use [a] trademark but [the] licensee has [an] allowable claim for damages for breach of contract") (internal citation omitted); *In re Exide*, 607 F.3d at 966 (Ambro, J., concurring).

¹³⁶ *In re Exide*, 607 F.3d at 966 (Ambro, J., concurring).

bankrupt licensor's goal of maximizing its assets, while not "let[ting] a licensor take back trademark rights it bargained away."¹³⁷

ii. Effect of Rejection

Section 365(g) treats a rejected executory contract as a breach of that contract.¹³⁸ Therefore, if a trustee rejects an executory contract under section 365(a), the non-debtor has the same rights as if the trustee merely breached the contract outside of bankruptcy.¹³⁹ In other words, the non-debtor may recover damages for the breach. Therefore, because Lakewood's rejection of the CAM license agreement "did not abrogate CAM's contractual rights," the Seventh Circuit held that CAM may continue using the Lakewood trademarks.¹⁴⁰

The *Sunbeam* decision has created a circuit split, yet after all active judges had an opportunity to review the opinion, none favored a hearing *en banc*.¹⁴¹ This could mean that all the other judges agreed with the *Sunbeam* decision or that they did not think the issue was significant enough to hear *en banc*.¹⁴²

¹³⁷ *Id.* at 967.

¹³⁸ 11 U.S.C. § 365(g) (2006).

¹³⁹ *Sunbeam Prods., Inc. v. Chi. Am. Mfg., LLC*, 686 F.3d 372, 376-77 (7th Cir. 2012).

¹⁴⁰ *Id.* at 378.

¹⁴¹ *Id.*

¹⁴² 7th Cr. R. 40(e) (Any proposed opinion that creates a circuit split must be circulated among all active judges and only after a majority of the judges vote against a hearing *en banc* can the opinion be published.).

C. Sunbeam's Effect on Bankruptcy Law

i. Sunbeam Redefines Section 365(g) and the Implications of Rejecting an Executory Contract

The Seventh Circuit is the first court of appeals to directly repudiate the *Lubrizol* decision.¹⁴³ The decision provides a second interpretation of Section 365(g) and the implications of rejecting an executory contract.¹⁴⁴ Trademark licensees will cite *Sunbeam* for the proposition that, despite rejection, Section 365(g) does not rescind the contract, but rather the licensee may retain its rights to the intellectual property.¹⁴⁵

In addition, *Sunbeam* may have some applicability to other forms of intellectual property not included in the Code's definition.¹⁴⁶ *Sunbeam* was not concerned with the underlying form of intellectual property, except to the extent that it was excluded from Section 365(n).¹⁴⁷ Because the form of intellectual property was not a determinative factor, there is no reason a licensee of a trade name, service mark, or foreign intellectual property should not invoke *Sunbeam* in support of continued use after rejection.¹⁴⁸ Had *Sunbeam* narrowed its holding to only trademarks, then its interpretation of

¹⁴³ *Sunbeam*, 686 F.3d at 376 (“No other court of appeals has agreed with *Lubrizol* – or for that matter disagreed with it. *Exide*, the only other appellate case in which the subject came up, was resolved on the ground that the contract was not executory and therefore could not be rejected.”).

¹⁴⁴ Compare *id.* at 377, with *Lubrizol Enterprises, Inc. v. Richmond Metal Finishers, Inc.*, 756 F.2d 1043, 1047 (4th Cir. 1985).

¹⁴⁵ *Sunbeam*, 686 F.3d. at 378. However, while the licensee may continue using the trademark, the unfilled obligations of the representative of the bankrupt's estate are converted into damages. Further, “nothing in this process implies that any rights of the [non-rejecting party] have been vaporized.” *Id.* at 377.

¹⁴⁶ Marc Fineman & Jonathan Friedland, *Seventh Circuit: Bankruptcy Code's Definition of 'Intellectual Property' Does Not Include Trademarks*, 29 THE BANKR. STRATEGIST, Oct. 2012, at 1, 5.

¹⁴⁷ See *Sunbeam*, 686 F.3d at 375. (which after confirming that Section 365(n) excludes trademarks, makes no mention of trademarks in its analysis).

¹⁴⁸ Fineman, *supra* note 146, at 5.

rejection under 365(g) may not apply to these other forms of intellectual property.

ii. While Trademark Licensees Can Do Without Section 365(n), Other Intellectual Property Licensees Cannot Forget About It

Following the *Sunbeam* decision, Section 365(n), to some extent, is meaningless in the Seventh Circuit for trademark licenses. This section leaves trademarks unaffected because “an omission is just an omission.”¹⁴⁹ Unable to invoke Section 365(n) for protection, trademark licensees must rely on *Sunbeam*’s interpretation of Section 365(g). While this benefits trademark licensees, patent and copyright licensees must continue to adhere to the terms of Section 365(n).¹⁵⁰

Licensees that fall under Section 365(n) may retain the rights gained under the agreement, but not without paying for it.¹⁵¹ For example, licensees must continue making royalty payments and waive “any right of setoff it may have with respect to such contract under this title or applicable nonbankruptcy law.”¹⁵² Therefore, it would be incorrect to claim that *Sunbeam* makes Section 365(n) wholly insignificant.

One can see why, depending on the nature of the intellectual property, this decision upsets certain licensees. Licensees subject to Section 365(n) in its current form will likely balk at the decision because while trademark licensees can retain the rights granted in the license, other intellectual property licensees must pay for the same retention. Expect licensees covered by Section 365(n) fight for reliance on Section 365(g), and therefore hope not to be subject to the costs associated with retaining rights under Section 365(n).

¹⁴⁹ *Sunbeam*, 686 F.3d at 375.

¹⁵⁰ See 11 U.S.C. § 365(n) (2006).

¹⁵¹ See *id.* at § 365(n)(2).

¹⁵² *Id.*

IV. COMPETING VIEWS

Now that there is a clear circuit split, it is only a matter of time before the Supreme Court reviews what happens to the non-debtor's property after a representative of the bankrupt estate rejects an executory contract or unexpired lease. On one hand, *Lubrizol* from the Fourth Circuit held that with subsequent rejection, the non-debtor party is stripped of the property and left with only a money damages claim for breach of contract.¹⁵³ On the other hand, the recently decided Seventh Circuit case, *Sunbeam*, held that rejection does not give the bankrupt party the right to recapture the asset.¹⁵⁴

A. Rejection as an Avoiding Power

The Seventh Circuit found that *Lubrizol* missed the mark when it equated rejection with an avoiding power.¹⁵⁵ While the Code entitles trustees to rescind certain contracts through the use of various avoiding powers,¹⁵⁶ rejection under Section 365 is not one of them.¹⁵⁷ “Avoiding-power rejection” is most often applied to the termination of real property leases and technology licenses.¹⁵⁸ While Congress has since made clear that rejecting a real property lease “has no avoiding-power effect,”¹⁵⁹ a brief explanation may help explain *Lubrizol*'s reasoning.

Section 365(h) of the Code “provides that despite the rejection of a real property lease in a lessor's bankruptcy, the lessee may remain in

¹⁵³ *Lubrizol Enters., Inc. v. Richmond Metal Finishers, Inc.*, 756 F.2d 1043, 1048 (4th Cir. 1985).

¹⁵⁴ *Sunbeam*, 686 F.3d at 377.

¹⁵⁵ *Id.* See Andrew, *supra* note 24, at 916.

¹⁵⁶ See 11 U.S.C. §§ 544, 545, 547-48 & 553 (2006).

¹⁵⁷ *Sunbeam*, 686 F.3d at 377 (“[R]ejection is not ‘the functional equivalent of a rescission, rendering void the contract and requiring that the parties be put back in the positions they occupied before the contract was formed.’” (quoting *Thompkins v. Lil’ Joe Records, Inc.*, 476 F.3d 1294, 1306 (11th Cir. 2007))).

¹⁵⁸ Andrew, *supra* note 24, at 902.

¹⁵⁹ *Id.*

possession for the term of the lease and any enforceable renewals, continuing to pay rent but offsetting any damages caused by nonperformance of the lessor's covenants under the lease.”¹⁶⁰ Like Section 365(n), this provision allows the non-debtor to retain possession of the property.¹⁶¹

Lubrizol alludes to the possibility that by enacting Section 365(h) Congress contemplated rejection as having an avoiding power effect.¹⁶² Had Congress envisioned rejection as simply freeing the debtor from any further obligations, while allowing the non-debtor to remain in possession of the property, could it not have stated so? Instead, Congress enacted exemptions as problems arose.¹⁶³ Therefore, *Lubrizol* could be defended on the grounds that Congress interpreted rejection as providing something similar to an avoiding power; and additionally, because Section 365(n) had not been enacted, it was

¹⁶⁰ *Id.* 11 U.S.C. § 365(h)(1)(A), which provides:

If the trustee rejects an unexpired lease of real property under which the debtor is the lessor and--

(i) if the rejection by the trustee amounts to such a breach as would entitle the lessee to treat such lease as terminated by virtue of its terms, applicable nonbankruptcy law, or any agreement made by the lessee, then the lessee under such lease may treat such lease as terminated by the rejection; or

(ii) if the term of such lease has commenced, the lessee may retain its rights under such lease (including rights such as those relating to the amount and timing of payment of rent and other amounts payable by the lessee and any right of use, possession, quiet enjoyment, subletting, assignment, or hypothecation) that are in or appurtenant to the real property for the balance of the term of such lease and for any renewal or extension of such rights to the extent that such rights are enforceable under applicable nonbankruptcy law.

¹⁶¹ Andrew, *supra* note 24, at 902-03. S. REP. NO. 100-505, at 3203 (1988) (“The bill provides for treatment of intellectual property licenses under Section 365 in a manner that parallels generally the treatment of real estate leases in the existing provision of Section 365(h)(1).”).

¹⁶² *Lubrizol Enters., Inc. v. Richmond Metal Finishers, Inc.*, 756 F.2d 1043, 1048 (4th Cir. 1985).

¹⁶³ See S. REP. NO. 100-505, at 3204 (1988), which states, “the bill is intended to respond to a particular problem arising out of recent court decisions under Section 365.”

proper to prevent the licensee from further use of the technology license.

Many lower courts did not challenge this holding, and thus have prevented trademark licensees from using the license after rejection.¹⁶⁴ For example, in *In re HQ Global Holdings, Inc.* the court held that a franchisee loses its right to use the trademark upon rejection.¹⁶⁵ The court reasoned that because Congress excluded trademarks from Section 365(n), *Lubrizol* controls, and upon rejection, the franchisee may no longer use the trademark.¹⁶⁶

In addition, the court in *In re Centura Software Corp.* held that rejection amounted to rescission because numerous authorities, including cases before and after Congress enacted Section 365(n), recognized *Lubrizol* as the dominating authority with regard to trademark license rejection.¹⁶⁷

Jurisdictions that follow *Lubrizol* would allow representatives of a bankrupt estate to reject unprofitable trademark license agreements and to shop around for something better. Worse yet, rejection could be used as a negotiating sword.¹⁶⁸ Licensees relying on the use of the license will be forced to renegotiate their agreement, lest they may otherwise lose the right to use the trademark. While Section 365(n) addresses the chilling effect that a *Lubrizol*-like decision creates with regard to copyrights and patents, trademarks are left in the cold. Ostensibly, trademark licensees will fight tooth and nail to avoid an interpretation of Section 365(g) that follows *Lubrizol*.

¹⁶⁴ See e.g., *In re Chipwich, Inc.*, 54 B.R. 427, 431 (Bankr. S.D.N.Y. 1985); *In re Blackstone Potato Chip Co., Inc.*, 109 B.R. 557, 562 (Bankr. D.R.I. 1990); *In re Centura Software Corp.*, 281 B.R. 660, 674 (Bankr. N.D. Cal. 2002); *In re HQ Global Holdings, Inc.*, 290 B.R. 507, 513 (Bankr. D. Del. 2003); *In re Old Carco LLC*, 406 B.R. 180, 211 (Bankr. S.D.N.Y. 2009).

¹⁶⁵ *In re HQ Global Holdings, Inc.*, 290 B.R. 507, 513 (Bankr. D. Del. 2003).

¹⁶⁶ *Id.*

¹⁶⁷ *In re Centura*, 281 B.R. at 673.

¹⁶⁸ *In re Exide Techs.*, 607 F. 3d 957, 967 (3d Cir. 2010) (Judge Ambro, concurring).

B. Sunbeam

The Seventh Circuit took a wholly different view in *Sunbeam*. In *Sunbeam*, Chief Judge Easterbrook stated that rejection did not entitle the trustee or debtor to reclaim the licensed property.¹⁶⁹ In *Sunbeam*, the court reasoned that just as breach outside of bankruptcy does not prevent a licensee from using the bargained for intellectual property,¹⁷⁰ breach within bankruptcy does not entitle the rejecting party to rescind the license agreement.¹⁷¹

While some courts have followed the *Lubrizol* interpretation, others have held that rejection does not extinguish the underlying obligation.¹⁷² In *In re Continental Airlines*, pilots for Continental Airlines brought a claim for furlough pay after Continental filed for Chapter 11 bankruptcy and rejected its collective bargaining agreement.¹⁷³ The Fifth Circuit held that because Section 365(g) specifically uses the term “breach,” rejection “does not invalidate the contract, or treat the contract as if it does not exist.”¹⁷⁴ One cannot breach a contract that does not exist.¹⁷⁵ Therefore, if, upon rejection, Continental could treat the collective bargaining agreement as if it did not exist, then the pilots would not have a claim for damages, which is clearly provided pursuant to Section 502(g) of the Code.¹⁷⁶

¹⁶⁹ *Sunbeam Prods., Inc. v. Chi. Am. Mfg., LLC*, 686 F.3d 372, 377 (7th Cir. 2012).

¹⁷⁰ *Id.* at 376.

¹⁷¹ *Id.* at 377.

¹⁷² Although not interpreting Section 365(g) in the same context as *Lubrizol* and *Sunbeam*, courts have interpreted Section 365(g) in other contexts. *See, e.g., In re Austin Dev. Co.*, 19 F.3d 1077, 1082 (5th Cir. 1994); *O’Neil v. Cont’l Airlines, Inc. (In re Cont’l Airlines)*, 981 F.2d 1450, 1459 (5th Cir. 1993); *Kopolow v. P.M. Holding Corp. (In re Modern Textile, Inc.)*, 900 F.2d 1184, 1191 (8th Cir. 1990); *Leasing Serv. Corp. v. First Bank Nat’l Ass’n*, 826 F.2d 434, 436 (6th Cir. 1987).

¹⁷³ *In re Cont’l Airlines*, 981 F.2d at 1451.

¹⁷⁴ *Id.* at 1459-60.

¹⁷⁵ *Id.*

¹⁷⁶ 11 U.S.C. § 502(g)(1) (2006) which provides:

Furthermore, in *In re Modern Textile, Inc.*, the Eighth Circuit held that rejection of an unexpired lease did not release the debtor of its legal obligation, but rather functioned “as a breach of an existing and continuing legal obligation of the debtor.”¹⁷⁷

While trademark licensees are obviously happy about the *Sunbeam* decision, licensees currently protected under Section 365(n) may be upset. Under *Sunbeam*, trademark licensees have an unfair advantage. By interpreting Section 365(g) as *Sunbeam* did, trademark licensees will receive the same protections that other intellectual property licensees currently receive under 365(n). Yet unlike other intellectual property licensees, trademark licensees do not need to comply with the terms of Section 365(n) in order to continue using the license.¹⁷⁸ Intellectual property licensees may view this outcome as a windfall for trademark licensees. While the Supreme Court will likely review what it means to reject an executory contract, treating trademarks differently from other intellectual property may prompt Congress to revisit Section 365(n).

CONCLUSION

Courts have struggled with the idea of rejecting executory contracts since the turn of the century.¹⁷⁹ While it is understood that rejecting amounts to a “breach,” exactly what it means to breach an executory contract is not always clear.¹⁸⁰ Over the years Congress has

A claim arising from the rejection, under section 365 of this title or under a plan under chapter 9, 11, 12, or 13 of this title, of an executory contract or unexpired lease of the debtor that has not been assumed shall be determined, and shall be allowed under subsection (a), (b), or (c) of this section or disallowed under subsection (d) or (e) of this section, the same as if such claim had arisen before the date of the filing of the petition.

In re Cont'l Airlines, 981 F.2d at 1459-60 (citing *Sanders v. City of Brady* (*In re Brady*, Tex. Mun. Gas Corp.), 936 F.2d 212, 214 (5th Cir. 1991).

¹⁷⁷ *In re Modern Textile, Inc.*, 900 F.2d at 1191.

¹⁷⁸ Section 365(n) requires licensees who decide to continue using the license despite rejection to continue paying royalties and to waive setoffs.

¹⁷⁹ Andrew, *supra* note 24, at 866.

¹⁸⁰ *Id.* at 870.

attempted to clarify rejection, beginning with real property lessees.¹⁸¹ After *Lubrizol*, Congress enacted Section 365(n) to protect intellectual property licensees from interpretations of Section 365(g) that, like *Lubrizol*, strip licenses from intellectual property licensees.¹⁸²

However, despite Section 365(n), trademark licensees were still at risk because trademarks were excluded from the provision.¹⁸³ Then came *Sunbeam*. The Seventh Circuit used *Sunbeam* to provide a different interpretation of Section 365(g).¹⁸⁴ Chief Judge Easterbrook properly rejected the *Lubrizol* interpretation, and instead held that rejection does not permit the rejecting party to recapture the licensed property.¹⁸⁵ Under *Sunbeam*, Section 365(n) is not necessarily needed because the case held that rejection does not prevent the licensee from using the license.

Licensors should be aware of how their circuit interprets Section 365 when deciding whether to reject an executory contract, and even when negotiating a new license agreement. Licensees must also understand how courts interpret rejection in their circuits because if courts follow *Lubrizol*, they may have additional bargaining power, if the licensor is either a new company, or one in financial straits. Because the Supreme Court denied *Sunbeam*'s writ of certiorari to review the Seventh Circuit's decision,¹⁸⁶ it remains to be seen whether Congress will now step in to clarify rejection, include trademarks in Section 365(n), or do nothing at all.

If Congress chooses to take no action, it will only lead to further confusion among the circuits. Ostensibly, other circuits will address this issue in the future and will need to decide for themselves what it means to reject an executory contract. While the Seventh Circuit and

¹⁸¹ *Id.* at 867.

¹⁸² S. REP. NO. 100-505, at 3202-03 (1988).

¹⁸³ *Id.* at 3204.

¹⁸⁴ See generally *Sunbeam Prods., Inc. v. Chi. Am. Mfg., LLC*, 686 F.3d 372 (7th Cir. 2012).

¹⁸⁵ *Id.* at 377.

¹⁸⁶ Order Denying Mot. Writ of Cert. Dec. 10, 2012.

scholars have criticized *Lubrizol*,¹⁸⁷ it is still technically good law in the Fourth Circuit. Circuits that have not yet addressed this issue may interpret rejection in any manner they choose.

Without any guidance from the Supreme Court, this issue will only be further muddled in the years to come. If other circuits choose not to follow *Sunbeam*'s reasoning, and instead base their decision on equity, then businesses looking to enter licensing agreements cannot be certain of how a court will interpret a possible rejection.

Furthermore, this lack of consistency among the courts will lead to inefficient negotiations and, ultimately, license agreements. The possibility that the licensor may reject the agreement should be considered when negotiating license agreements. A licensee should be compensated for taking the risk of rejection if a court in that jurisdiction requires the licensee to give up the trademark. However, if a court rules that rejection does not prevent the licensee from using the trademark, then the licensee received a benefit that it did not bargain for or necessarily deserve. Without a consistent interpretation of rejection, contracting parties are unable to efficiently negotiate an agreement that benefits both sides.

Despite the Supreme Court's denial of *Sunbeam*'s *writ of certiorari*, it is important that the Supreme Court review what it means for a licensor to reject a trademark license. Perhaps in the near future the Supreme Court will settle this rejection business once and for all.

¹⁸⁷ *Sunbeam*, 686 F.3d at 377-78; Andrew, *supra* note 24, at 916-19; Jay Lawrence Westbrook, *The Commission's Recommendations Concerning the Treatment of Bankruptcy Contracts*, 5 AM. BANKR. INST. L. REV. 463, 470-72 (1997).